

IN THE
United States Court of Appeals
For the Ninth Circuit

RUTH STERNS, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

CY STERNS, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petitions for Review of the Decisions of the
Tax Court of the United States

BRIEF FOR THE RESPONDENT

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**On Petitions for Review of the Decisions of the
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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 31-39) are not officially reported.

JURISDICTION

These petitions for review (R. 41-48) involve federal income taxes for the taxable years 1943 and 1944. On September 21, 1951, the Commissioner of Internal

Revenue mailed to taxpayers notices of the deficiencies in the total amount of \$152,507.36. (R. 7-11, 21-26.) Within 90 days thereafter, and on December 12, 1951, the taxpayers filed petitions with the Tax Court for a redetermination of these deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3-11, 16-26.) The decisions of the Tax Court sustaining the deficiencies in the total amount of \$57,958.10 were entered on October 26, 1954. (R. 39-40.) This case is brought to this Court by petitions for review (R. 41-48) filed pursuant to Sections 7482 and 7483 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

Taxpayers (husband and wife) sold liquor in excess of O.P.A. ceiling prices, and failed to keep accurate records of receipts and expenditures. The Commissioner reconstructed their taxable incomes on the basis of their bank deposits and undeposited cash receipts, reduced by non-income items and allowable deductions. The questions presented are:

1. Whether the Tax Court erred in sustaining, in part, the Commissioner's determination that taxpayers understated their taxable incomes in their 1943 and 1944 tax returns.

2. Whether the Tax Court erred in sustaining the Commissioner's determination that part of the deficiencies in the taxpayer husband's taxes was due to fraud with intent to evade tax.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer*.—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U.S.C. 1952 ed., Sec. 54.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud*.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

(26 U.S.C. 1952 ed., Sec. 293.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.51-1 [As amended by T.D. 5381, 1944 Cum. Bull. 188]. *Records and Income Tax Forms*.—Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commis-

sioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Every organization exempt from tax under section 101 but required by section 54(f) to file an annual return shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts, and disbursements, and such other information as is required by section 29.101-2. The books or records required by this section shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.

* * * *

STATEMENT

The relevant facts, which were found by the Tax Court (R. 33-37), may be summarized as follows:

Taxpayers, husband and wife, were residents of California and filed individual income tax returns for the years 1943 and 1944 with the Collector for the Sixth District of California. Their returns were filed on a cash basis. (R. 33.) Since the issues involved in this appeal relate to the business conducted by Cy Sterns, he will be referred to hereinafter as the taxpayer.

In 1943, taxpayer, through contacts with various distillers, was able to secure the delivery of quantities of liquor which was then in short supply. He also had

customers for the liquor, but he did not have a license or facilities for conducting a wholesale business. In order to facilitate his sales of liquor, he entered into an agreement on October 1, 1943, with the South Pacific Wholesale Company, hereinafter referred to as South Pacific, a wholesale liquor dealer located in Los Angeles. This agreement provided, among other things, that taxpayer was to secure the delivery of liquor from distillers to South Pacific. South Pacific was to pay the invoice price, taxes, and handling charges on each shipment, make delivery of the liquor to taxpayer's customers, and, after deducting its fee, was to account to taxpayer for all profits realized. For its services, South Pacific was to receive a fee of \$2 a case. (R. 33-34.)

During 1943 and 1944, South Pacific handled, in accordance with this agreement, 13,344 cases of liquor for taxpayer. In some instances taxpayer's customers paid South Pacific for the liquor; in other instances they paid taxpayer directly. Payments were made both by check and in cash. (R. 34.)

During 1943 and 1944 taxpayer sold liquor at prices in excess of the maximum ceiling prices established by Office of Price Administration. In October, 1946, he was convicted in the United States District Court for the Northern District of California for violating the Emergency Price Control Act of 1942, as amended. The offense for which he was convicted occurred in 1944. (R. 34.)

Taxpayer did not keep any books or records of either his business or personal receipts and expenditures. The only record allegedly kept by him consisted of a

loose leaf book which purported to show his sales of liquor at O.P.A. prices, and the amounts of his refunds to customers during 1943 and 1944. The books and records of South Pacific did not reflect the amounts paid by taxpayer's customers either to South Pacific or to taxpayer. (R. 34.)

Taxpayer's net income or loss from business for 1943 and 1944, as reported in his tax returns, and as determined by the Commissioner, are as follows (R. 35):

Year	Income Reported in Return	Income Determined by Commissioner
1943	\$10,204.61	\$160,492.21
1944	(2,881.18)	75,615.24

In 1943 and 1944 taxpayer deposited in various banks in Los Angeles business receipts totaling \$211,214.68 and \$76,088.91, respectively. A part of taxpayer's business receipts for each year were not deposited in any bank. (R. 35.)

The Commissioner reconstituted taxpayer's net income from business by including in taxpayer's gross income for each year the total of his bank deposits plus undeposited checks and cash, after making allowance for such identifiable non-income items as loans, redeposits and transfers from one bank account to another. The Commissioner allowed deductions in each year from the gross income thus determined for substantiated business expenses. (R. 35.)

The Tax Court found that the Commissioner was justified in reconstructing taxpayer's net income from

business by use of an acceptable method. However, the Tax Court found that the following items included by the Commissioner in taxpayer's gross income from business for 1943 did not constitute income to him (R. 35):

Item	Amount
Checks from South Pacific payable to H. P. Hanthorn	\$ 2,908.74
Checks from South Pacific payable to Mike O'Hara	2,000.00
Funds used by taxpayer to purchase a telegraphic money order	25,000.00
Total	<u>\$29,908.74</u>

The Tax Court also found that taxpayer was entitled to business expense deductions for 1943, in addition to the amounts allowed by the Commissioner, for refunds to customers, for cost of merchandise, and for miscellaneous expenses, as follows (R. 36):

Item	Amount allowed by Commissioner	Amount paid by taxpayer	Additional deduction
Refunds to customers	\$29,564.70	\$41,620.35	\$12,055.65
Cost of merchandise	97,637.91	129,360.34	31,722.43
Miscellaneous expense		2,681.74	2,681.74
Totals	<u>\$127,202.61</u>	<u>\$173,662.43</u>	<u>\$46,459.82</u>

Taxpayer made these refunds to customers in cash in the amount of \$10,465.35 and by check in the amount of \$31,155. (R. 36.)

The Tax Court then found that in 1943 taxpayer's net income from business was not less than \$91,749.30. (R. 36.)

The Tax Court found the following items included by Commissioner in taxpayer's gross income from business for 1944 did not constitute income to him (R. 36):

Item	Amount
Loans to taxpayer	\$10,450
Bank deposit in name of Mrs. H. P. Hanthorn	2,538
	<hr/> \$12,988.

The Tax Court found that taxpayer was entitled to business expense deductions for 1944, in addition to amounts allowed by the Commissioner, for refunds to customers, for cost of merchandise and for miscellaneous expense, as follows (R. 36):

Item	Amount allowed by Commissioner	Amount paid by taxpayer	Additional deduction
Refund to customers	\$10,140.00	\$13,638.35	\$ 3,498.35
Cost of merchandise	45,695.65	55,218.35	9,522.70
Miscellaneous expense		7,204.69	7,204.69
Totals	<hr/> \$55,835.65	<hr/> \$76,061.39	<hr/> \$20,225.74

Taxpayer made these refunds to customers in cash in the amount of \$3,900, and by check in the amount of \$9,738.35. (R. 36-37.)

The Tax Court then found that in 1944, taxpayer's net income from business was not less than \$46,301.50 (R. 37.)

Taxpayers, Ruth and Cy Sterns, paid medical expenses in 1944, in the amount of \$1,575.08. The Tax Court found that they were not entitled to any business expense deductions for taxes or charitable contributions for 1944. (R. 37.)

The Tax Court found that there were deficiencies in taxpayers' incomes for the years 1943 and 1944, in the amount of \$57,958.10. (R. 39-40.) The Tax Court also found that part of the deficiency in taxpayer Cy Sterns' income for each of the years 1943 and 1944 was due to fraud with intent to evade tax, but that no part

of the deficiencies of taxpayer Ruth Sterns for those years was due to fraud. (R. 37-39.)

SUMMARY OF ARGUMENT

1. Taxpayer's corrected net income was properly ascertained by the bank deposit method. The evidence revealed the probable source of the additional, unreported income as coming from the sale of liquor at prices in excess of O.P.A. ceiling prices. Taxpayer was given every opportunity to explain these large discrepancies, and as to those items which he could substantiate, the Tax Court adjusted the Commissioner's figures. Since taxpayer could not explain the remaining portions of the discrepancies between his reported income and his income as reconstructed by the bank deposit method, the Tax Court was not required to accept taxpayer's unsupported statements. On the evidence before it, the Tax Court properly found that the unexplained discrepancies represented unreported income for 1943 and 1944.

2. The evidence warranted the imposition of the fraud penalty as to taxpayer Cy Sterns. There were substantial discrepancies between his reported and true income for both 1943 and 1944, and he did not keep any books and records of his business transactions which showed the amount of income received by him. Furthermore the evidence, including admissions by taxpayer, testimony of other witnesses and the record of his conviction for O.P.A. violations in 1944, all disclose that taxpayer received income from black market operations which he failed to disclose. The Tax Court did not rely upon taxpayer's prior conviction as con-

clusive, but properly regarded the record of his conviction as admissible to impeach his testimony.

ARGUMENT

I

The Evidence Fully Supports the Tax Court's Determination of Taxpayers' Corrected Net Incomes by the Bank Deposit Method

During the years 1943 and 1944 taxpayers, Cy Sterns and Ruth Sterns, filed income tax returns reporting a total net income of \$7,028.32. (Exs. 1A, 2B, 3C, 4D.) The Tax Court found that taxpayers had a total net income of not less than \$138,050.80 for the same two years. (R. 36-37.) The evidence disclosed that taxpayer, Cy Sterns, was engaged in the wholesale liquor business in 1943 and 1944, in which he secured the delivery of approximately 13,344 cases of liquor from distillers to South Pacific Wholesale Company, a wholesale liquor dealer located in Los Angeles, which cases were sold to taxpayer's customers. South Pacific paid the invoice price, taxes and handling charges on each shipment, made deliveries of the liquor to taxpayer's customers, and, after deducting its fees, accounted to taxpayer for the profits realized. In some instances, taxpayer's customers paid South Pacific for the liquor; in other instances, they paid taxpayer directly. In all instances, payments were made either in cash or by check. (R. 63-67, 127-133, 135-138, 184-186, 208, 228, 301-303, 327-328; Exs. 11, 12, H.)

The evidence also discloses that taxpayer sold liquor at prices in excess of the maximum ceiling prices established by the Office of Price Administration. (R. 72-74, 111-112, 118-119, 207-209, 230-231.) Although

taxpayer received large amounts of cash and many checks from his customers in payment of liquor sold to them he did not keep any books or records of either his business or personal receipts and expenditures and did not produce any record showing the amount of his gross receipts or costs at the hearing before the Tax Court.¹ Although South Pacific maintained records of the transactions it handled for taxpayer, its records did not include the amounts paid by taxpayer's customers to him for cases of liquor. (R. 307-309.) Thus, there were not any records which accurately set forth the amounts received from the sales of the 13,344 cases of liquor sold by taxpayer. In such circumstances the Commissioner was fully justified in resorting to taxpayer's bank deposits in order to reconstruct his true net incomes for these years. *Holland v. United States*, 348 U.S. 121, 130-132; *Gobins v. Commissioner*, 217 F. 2d 952 (C.A. 9th), affirming, *per curiam*, 18 T.C. 1159; *Roberts v. Commissioner*, 176 F. 2d 221, 226 (C.A. 9th); *Rose v. Commissioner*, 188 F. 2d 355 (C.A. 9th), certiorari denied, 312 U.S. 850; *Thomas v. Commissioner*, 223 F. 2d 83, 86 (C.A. 6th); *Bodoglau v. Commissioner* (C.A. 7th), decided February 29, 1956. It has long been settled, both by this Court and by other Courts of Appeals, that under circumstances, such as are involved in this case, the Commissioner is justified in treating as income an unexplained excess of bank deposits over reported income. *Gobins v. Commissioner*, *supra*; *Goe v. Commissioner*, 198 F. 2d 851

¹ The only record maintained by taxpayer was a black book (Ex. G) which listed the amount of cases sold to individuals and the sales prices, plus the amount of refunds by cash and by check. However, this book did not contain any record of payments for cases made either to taxpayer or to South Pacific. (R. 340-342.)

(C.A. 3d); *Halle v. Commissioner*, 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; *Hague Estate v. Commissioner*, 132 F. 2d 775 (C.A. 2d), certiorari denied, 318 U.S. 787; *Mauch v. Commissioner*, 113 F. 2d 555 (C.A. 3d); *Hoefle v. Commissioner*, 114 F. 2d 713 (C.A. 6th); *Marcella v. Commissioner*, 222 F. 2d 878 (C.A. 8th). "Where, as here, the records kept by the taxpayer are manifestly inaccurate and incomplete, the Commissioner may look to other sources of information to establish income". *Boyett v. Commissioner*, 204 F. 2d 205, 208 (C.A. 5th). See also, *Greenfeld v. Commissioner*, 165 F. 2d 318 (C.A. 4th).

It is equally well settled, as illustrated by the above cases, that the Commissioner's deficiency determination is presumptively correct; that the taxpayer has the burden of proving it to be wrong; that the Tax Court is not obliged to accept the taxpayer's uncorroborated testimony regarding his receipts and expenditures; and that the Tax Court's finding that a taxpayer has understated his income may not be disturbed on appeal unless it is clearly erroneous.

In the present case, taxpayer listed his income for 1943 as \$17,004.37 of salaries from South Pacific and two other companies, less \$6,799.76 of business expenses, resulting in total income of \$10,204.61. (Ex. 3C.) In his amended return for 1944, taxpayer listed \$26,868.82 of commissions and \$29,750 of expenses and commissions paid, resulting in a net operating loss of \$2,881.18. (Ex. 4D.) There do not appear to be any records substantiating these amounts of salaries and commissions received, or expenses paid.

In view of the great discrepancy between taxpayer's reported incomes for these years and his bank deposits,

plus other undeposited cash and checks received by taxpayer, which was not explained by him, the Commissioner sought to reconcile these amounts and determined taxpayer's income as follows: It was stipulated that taxpayer's gross bank deposits were \$211,-214.68 in 1943, and \$76,088.19 in 1944. (R. 246.) The revenue agent who investigated taxpayer's returns analyzed taxpayer's bank deposits and withdrawals for 1943, and added to his deposits \$30,599.95 of undeposited checks received from South Pacific in the form of commissions and \$88,801.70 in undeposited currency used to purchase cashier checks. The revenue agent deducted from this gross figure the sums of \$42,921.51 representing nontaxable transfers and redeposits in the four banks in which taxpayer had accounts, \$29,-564.70 of refunds made by taxpayer to customers for deposits left with him and \$97,637.91 of payments by taxpayer to South Pacific for merchandise handled by that company for him. The revenue agent thus arrived at a net figure of \$160,492.21, which represented taxpayer's income for 1943. (R. 248-250, 294-295.)

For 1944, the revenue agent added to the stipulated deposits of \$76,088.19 the amounts of \$26,281.87 of undeposited checks received from South Pacific as commissions, \$26,777.75 of undeposited currency and \$2,-538.00 of deposits to the account of Mrs. H. P. Hanthorn. From this gross amount the revenue agent eliminated \$235.64 of bank transfers, \$10,140 of refunds to customers, \$45,695.65 of cashier checks and other checks made out to South Pacific for the purchase of liquor, leaving a net figure of \$75,615.24, which represented taxpayer's income for 1944. (R. 250-251.)

In arriving at these results, the revenue agent testified that in order to minimize the possibilities of duplication he had photostats made of South Pacific's checks which were endorsed by taxpayer, and of most of the cashier checks made out by taxpayer to South Pacific, and that he had secured copies of the deposit slips made out by taxpayer for his accounts, which listed the individual deposits of cash and checks. (R. 254, 258, 262-266, 268-270, 275; Exs. P, Q, R.) The Revenue Agent also testified that he interviewed the persons to whom taxpayer said he made refunds in cash and by check, and deducted these amounts from his determination of taxpayer's gross incomes for the years 1943 and 1944. (R. 268-271, 276-277, 281.)

Taxpayer contended in the Tax Court that the Commissioner's determination of taxpayer's income was erroneous in that taxpayer was not credited for withdrawals for accommodation sales to his customers of higher grade liquor at higher prices (R. 69-71, 141), for refunds to his customers (R. 90), for larger payments to South Pacific (R. 136-137, 321-326, 331-336) and for business expenses (R. 67-68).

Upon all of the testimony, and after receiving all the exhibits, the Tax Court modified the Commissioner's determination of taxpayer's incomes for both years by excluding various loans or inter-bank transfers, testified to by taxpayer, in the amount of \$29,908.74 for 1943, and \$12,988 for 1944. In addition, the Tax Court permitted taxpayer to take deductions for business expenses in the amount of \$2,681.74 for 1943, and \$7,204.69 for 1944, which amounts were substantiated by checks made out by taxpayer. (Exs. 11 and 12.) Al-

though part of the taxpayer's figures for his cost of goods was estimated by him and was not substantiated by either his records or by those of South Pacific (R. 321-326, 331-336), nevertheless the Tax Court permitted taxpayer additional deductions for this item for both years. (R. 36.) Thus, the only other items as to which large discrepancies existed between the revenue agent's examination and taxpayer's returns concerned the amount of accommodation sales and refunds made by taxpayer to his customers. Here the Tax Court permitted taxpayer additional deductions for all amounts which he could substantiate by checks or otherwise (Exs. G, 11, 12), in the amount of \$12,-055.65 for 1943, and \$3,498.35 for 1944.

After making all these deductions, the Tax Court found that taxpayer had a net income from his business of not less than \$91,749.30 for 1943, as contrasted with \$10,204.61 reported in his and his wife's returns for that year, and a net income of not less than \$46,-301.50 for 1944, as contrasted with a net loss of \$2,881.18 reported in his and his wife's returns. (R. 35-37.)

Accordingly, the first question presented to this Court is whether the Tax Court properly found, upon all the evidence, that there were deficiencies in taxpayer's incomes for these years. In the present case, the Tax Court gave to taxpayer every opportunity to explain these large discrepancies between his reported income and his income determined by the Commissioner, and to show that these amounts did not represent taxable income to him. The Tax Court even reopened the case for additional testimony to enable tax-

payer to substantiate his testimony that he had paid additional amounts to South Pacific for merchandise, made large amounts of accommodation sales at losses to his customers, or made additional refunds to his customers. Although neither taxpayer nor his accountant were able to verify or substantiate taxpayer's contentions, and neither South Pacific's records or his black book contained any record of such payments (R. 154, 321-326, 331-336; Ex. G), nevertheless the Tax Court permitted taxpayer to deduct several items which were estimated by him but which were not verified by any checks, withdrawals, etc. (Exs. 11, 12.)

However, even after taxpayer was permitted these additional credits, the Tax Court found that a large discrepancy existed between the amount of taxpayer's deposits and his business deductions and nontaxable items. Here the record fully supports the Tax Court's findings that this excess was derived by taxpayer from sales of liquor at over-ceiling prices, and that these excess amounts received were not entered in any records, either in taxpayer's black book or in South Pacific's books. (R. 121, 322.) Several witnesses testified that they paid to taxpayer, or his agent, black market prices for liquor (R. 207-209, 230-231), and taxpayer himself admitted to selling at black market prices and to being convicted for black market activities in 1944 (R. 72-74, 111-112, 118-119).

Under these circumstances, the Tax Court's findings and conclusions, that taxpayer grossly understated his incomes for 1943 and 1944, and that he had not less than \$91,749.30 of business income for 1943, and \$46,301.50 of business income for 1944 (R. 36, 37), is supported

by substantial evidence, and has not been shown to be “clearly erroneous”. It should also be noted that taxpayer has not attacked these findings of the Tax Court on this appeal. Consequently, it is submitted that these findings and conclusions of the Tax Court should be sustained by this Court. Rule 52(a), Federal Rules of Civil Procedure; *United States v. Gypsum Co.*, 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869.

Taxpayer’s contention that because of his lack of education he need not keep complete records, that he could rely upon South Pacific’s records, and that his returns reasonably reflected both his and his wife’s income for 1943 and 1943 (Br. 13-18) is without merit. It is clear that where a taxpayer maintains an active and substantial business he cannot justify his failure to keep records sufficient to disclose his true income upon the ground of a lack of education. Neither could he rely upon the records of others where, as here, they do not include all the amounts received from the sale of merchandise, nor upon the fact that his returns were prepared by an accountant where he does not furnish his accountant with all the necessary information. Finally, as we have shown, both taxpayer and his wife’s returns grossly understated their incomes for both years. Equally without merit is taxpayer’s suggestion (Br. 32) that he could not have understated his taxable income because his assets were “entirely dissipated” by the end of 1944, since there is no showing that the assets were used to pay deductible items.

Taxpayer argues (Br. 13-32) that his “method of accounting” clearly reflected his taxable income, and that therefore under Code Section 41 the Commis-

sioner and the Tax Court were precluded from using some other method. But, as the Supreme Court pointed out in *Holland v. United States*, 348 U.S. 121, 130-132, the phrase "method of accounting" as used in Section 41 has reference to such methods as the cash receipts and accrual system of accounting; it has no applicability to a situation where, as here, the taxpayer's "method" does not accurately reflect his receipts at all and the Commissioner merely (p. 131) "calls upon taxpayers to account for their unexplained income".

Taxpayer's reliance (Br. 18-32) upon *Helvering v. Taylor*, 293 U.S. 507, and similar cases, is manifestly misplaced. It was there held that, where the Commissioner's deficiency determination was shown to be arbitrary and clearly excessive, and the Tax Court had failed to afford the taxpayer an opportunity to prove the correct amount of tax due, the Court of Appeals was empowered to remand the case in order to afford the taxpayer such an opportunity. The *Taylor* holding that a case may be remanded to permit the taxpayer to introduce further evidence in no wise detracts from the familiar rule that the taxpayer is required "to show not only that the Commissioner is wrong but also to produce evidence from which a proper determination may be made". 9 Mertens, Law of Federal Income Taxation, p. 286. Taxpayer here was afforded full opportunity to meet the burden of proving the Commissioner's determination to be wrong, and to the extent that taxpayer proved it to be wrong the Tax Court overruled the Commissioner and reduced the asserted deficiency. What is more, the Tax Court even reopened the case to permit taxpayer to

introduce additional evidence, yet taxpayer was still unable to substantiate his contentions. Taxpayer thus had every opportunity to prove his case and to remedy the deficiencies in his proof. Accordingly, there is no basis for a remand here, as there was in *Taylor*. Indeed a remand for the purpose of affording taxpayer still another opportunity would be futile, since taxpayer's failure of proof stems from his own failure to keep adequate records.

In short, the only question in this case is the purely factual one of the amount of taxpayer's taxable income. In effect taxpayer takes the untenable position that the Commissioner—rather than the taxpayer—had the burden of proving the correct amount. The rule is precisely the opposite. Even apart from established rules as to burden of proof in tax cases, the obligation to furnish evidence showing the Commissioner's determination to be wrong, and to what extent it was wrong, plainly rested on the taxpayer, since the evidence as to the amount of his receipts was peculiarly within his knowledge. Having failed to keep adequate records, taxpayer is scarcely in a position to complain of the Tax Court's determination of the correct amount of his income. *Chesbro v. Commissioner*, 225 F. 2d 675 (C.A. 2d), petition for certiorari pending. Clearly the Tax Court was not obliged to accept taxpayer's self-serving uncorroborated assertions to the effect that he accounted for all his income. Even in a criminal tax proceeding—where the taxpayer is charged with understating his income with intent to evade tax and the Government has the burden of proving the charge beyond a reasonable doubt—the trial tribunal is not

bound to accept the testimony of a taxpayer who fails to keep adequate books and records, and may accept a figure based on the Government's reconstruction of the taxpayer's income. *Holland v. United States*, 348 U.S. 121. *A fortiori* the trial court is not bound to do so where as here the Government asserts only a civil tax liability—a deficiency in tax which is presumptively correct and which the taxpayer has the burden of proving incorrect. Nor was the Tax Court obliged either to sustain or reject the Commissioner's deficiency determination in toto, as taxpayer apparently assumes. The Tax Court was of course required to reduce the deficiency to the extent that the evidence showed it to be excessive, and it did so to that extent. However, it properly refused to overrule the Commissioner's determination in its entirety, and since its findings as to the correct amount of taxpayer's income is warranted by the record those findings are entitled to finality here. *Rose v. Commissioner*, 188 F. 2d 355 (C.A. 9th), certiorari denied, 312 U.S. 850; *Goe v. Commissioner*, 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Halle v. Commissioner*, *supra*; *Chesbro v. Commissioner*, *supra*.

II

The Evidence Fully Supports the Tax Court's Finding That for Each of the Years Involved a Part of Taxpayer, Cy Sterns', Deficiencies Were Due to Fraud With Intent to Evade Tax

The question whether taxpayer filed his returns for 1943 and 1944, with intent to evade tax is a question of fact, as to which the burden of proof is upon the Commissioner. Section 1112 of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 1112). However,

the nature and extent of that burden is well settled. Contrary to taxpayer's contentions (Br. 39) the penalty imposed by Section 293(b) of the Internal Revenue Code of 1939, *supra*, is a civil sanction, not a criminal penalty," and "there is no burden upon the Government to prove its case beyond a reasonable doubt * * *." *Helvering v. Mitchell*, 303 U.S. 391, 403, and cases cited in footnote 9; *Spies v. United States*, 317 U. S. 492, 495. It is also well settled that the Tax Court's finding on the issue of fraud is entitled to finality unless "clearly erroneous", with due regard given to the trial court's ability to judge the credibility of the witnesses. Rule 52(a), Federal Rules of Civil Procedure; Section 7482 of the Internal Revenue Code of 1954 (26 U.S.C. 1952 ed., Supp. II, Sec. 7482). The finding here that a part of taxpayer Cy Sterns' deficiencies was due to fraud with intent to evade tax (R. 37) has substantial support in the record and therefore should not be disturbed on appeal. *Rose v. Commissioner*, decided January 6, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,005), affirmed *per curiam*, 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Helvering v. Kehoe*, 309 U.S. 277; *Bodoglau v. Commissioner*, *supra*; *Goe v. Commissioner*, *supra*; *Halle v. Commissioner*, *supra*, pp. 503-504; *Harris v. Commissioner*, 174 F. 2d 70 (C.A. 4th).

It has been long recognized, contrary to taxpayer's contentions (Br. 40), that proof of fraud by direct evidence is seldom possible, but generally must be found

² See *Reimer's Estate v. Commissioner*, 180 F. 2d 159 (C.A. 6th); *Scadron's Estate v. Commissioner*, 212 F. 2d 188 (C.A. 2d), certiorari denied, 348 U.S. 832.

from surrounding circumstances. For example, the Tax Court found that the returns filed by taxpayer, Cy Sterns, failed to disclose substantial amounts of income (R. 36-38), and not minor amounts as contended by taxpayer for both 1943 and 1944. Such large discrepancies between real and reported income for two consecutive years is alone strong evidence of an intent to evade the payment of taxes. *Hargis v. Godwin*, 221 F. 2d 486, 490 (C.A. 8th); *Rogers v. Commissioner*, 111 F. 2d 987, 989 (C.A. 6th), where discrepancies existed for three consecutive years.

Further proof of taxpayer's intent to evade is found in his failure to keep any books or records of business operations. Although taxpayer presented a black notebook before the Tax Court (Ex. G) which purported to contain some records, neither it nor the records of South Pacific, which taxpayer contends he relied upon to prepare his returns (Br. 49), contained any information as to the amounts which taxpayer received from his sales of liquor. Nor would taxpayer's reliance upon the assistance of others (Br. 49) negate the existence of fraud, since these other persons relied solely upon information furnished by taxpayer and he failed to give to them any records of amounts received from his black market sales. In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. *Helvering v. Mitchell*, *supra*, p. 399; *Spies v. United States*, *supra*, pp. 495-496; *Halle v. Commissioner*, *supra*, p. 502. An examination of the entire record strongly supports the belief that the reason for taxpayer's failure to keep records and make proper disclosures is that he re-

ceived large amounts of income from black market sales of liquor which he knew was illegal. This conclusion is supported, as we have shown *supra*, by admissions by taxpayer himself, by testimony of other witnesses and by his conviction for over-ceiling sales in 1944. (R. 111-112, 118-119, 207-209, 230-231; Ex. F.)

It appears that taxpayer's omission of large amounts of income was not due merely to some carelessness or negligence as taxpayers contend (Br. 45, 48-49), or due to his lack of education (Br. 43, 45, 48), but was clearly due, as the Tax Court found (R. 39), to an intent to evade. Accordingly, it is apparent that, contrary to taxpayers' contentions (Br. 39-50), there is an abundance of evidence, clear and convincing which supports the Tax Court's ultimate finding of fraud.³

Taxpayer contends (Br. 32-38) that evidence pertaining to a prior conviction for violation of the Emergency Price Control Act (Ex. F) should have been excluded, although admittedly (Br. 32) no objection was made to its admission. The Tax Court's determination of deficiencies and of fraud did not depend upon taxpayer, Cy Sterns' conviction. The cases which have permitted the Commissioner to use an alternate method to determine a taxpayer's income have not required the Commissioner to prove the exact amounts of the unreported income or the source from which such unreported income was obtained, except to show that there was a business source of income available

³ Cases cited by taxpayers (Br. 40-48) are not applicable, since the Tax Court there held, as a matter of fact, the Commissioner had not met his burden, whereas in the present case the Tax Court reached the opposite conclusion, and taxpayers have not shown the Tax Court's conclusion to be clearly erroneous.

to the taxpayer. Cf., *Gendelman v. United States*, 191 F. 2d 993 (C.A. 9th). Thus, where the use of the bank deposit method turns up large discrepancies between real and reported income, and these discrepancies can arise out of taxpayer's business, this alone would be sufficient to sustain the imposition of these deficiencies. Similarly, the existence of large deficiencies for two consecutive years, plus taxpayer's failure to keep records, would sustain the finding of fraud without the introduction of taxpayer's conviction. Furthermore, the Tax Court's reference to taxpayer's over-ceiling sales could have been in response to taxpayer's admissions and the testimony of others in this regard, and not depend upon the introduction of the conviction.

Furthermore, the Tax Court was correct in admitting the record of taxpayer Cy Sterns' prior conviction of O.P.A. violations during 1944, one of the years involved in this proceeding, and in permitting cross-examination based thereon for purposes of impeaching taxpayer's credibility. By statute (Section 1111 of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 1111)), the Tax Court was bound by the rules of evidence applicable in the courts of the District of Columbia in the type of proceedings formerly within the jurisdiction of courts of equity of the District. As in many other jurisdictions, the District of Columbia provides by statute that the fact that a witness has been convicted of a crime may be given in evidence to affect his credibility as a witness, in either civil or criminal proceedings. District of Columbia Code (1951 ed.), Section 14-305. In his brief it appears

that taxpayer confuses conclusiveness and admissibility (Br. 32-38), for although a judgment in a prior cause is not necessarily conclusive in a second proceeding, it is admissible for purposes of impeaching the testimony of a witness in a second criminal or civil proceeding (*Campbell v. United States*, 176 F. 2d 45 (C.A. D.C.); *United States v. Boyer*, 105 F. 2d 595 (C.A. D.C.); *Goode v. United States*, 149 F. 2d 377 (C.A. D.C.); *Hall v. Gordon*, 128 F. 2d 461, 462, (C.A. D.C.)), and is also admissible *as evidence* where the issues in both proceedings are substantially the same and the convicted person is a party to both proceedings (cf. *New York & Cuba Mail S. S. Co. v. Continental Ins. Co.*, 117 F. 2d 404, 411-412 (C.A. 2d)). See, Wigmore on Evidence, (Third ed.), Vol. III, Section 980, Vol. IV, Section 1346a.

Since the Tax Court did not rely upon the conclusiveness of the facts in taxpayer Cy Sterns' prior conviction but merely considered the conviction to determine the veracity of taxpayer's testimony, it would appear that the opinion of *Kilpatrick v. Commissioner*, 227 F. 2d 240, 243 (C.A. 5th), admitting similar records of conviction in a tax proceeding is particularly applicable herein. As was recently said by the Second Circuit Court of Appeals in a case strikingly similar to this one (*Chesbro v. Commissioner*, 225 F. 2d 674), "That a witness [taxpayer] had engaged in practices violative of federal price controls is a factor properly to be considered in judging his credibility".

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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